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Trade Policy

# Securing Market Access:

## Canada's Trade Agenda for the 1990s

by

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Canada is pursuing trade negotiations on a number of fronts. The revived GATT talks are expected to result in more predictable rules in dealings with the U.S. and other major markets. Talks on a North American free trade area, on the other hand, may not yield a major increase in access to the U.S. market. Yet such access is of vital importance in sustaining Canadians' high standard of living.

Many countries are now focusing on enhanced regional trade links as part of their competitiveness policy. The United States remains the natural market in which Canadian firms seek greater overall penetration, and a strategy of further enhancing access to that market would improve the competitiveness of Canadian industry.

The Canada-U.S. Free Trade Agreement was a giant step in the right direction, but it failed to create a situation where Canadian firms could sell in the United States without fear of U.S. trade remedy laws. Chapter 19 of the FTA mandated the two countries to deal with this problem by developing an acceptable system of rules covering government subsidies and unfair pricing.

In these talks, Canada should seek to have its industries sheltered from U.S. trade remedy action. While the United States is unlikely to agree to amend its practices simply to gain better access to the Canadian market, there will still be room to limit the situations under which antidumping and countervailing duty cases can be brought against each other's nationals.

In aiming for this goal, Canada must be innovative in its negotiating stance; at the same time, it should seek to retain the current binational dispute settlement mechanism beyond its envisaged expiry date. For Canada, a continued focus on securing greater access to the U.S market is not incompatible with the objective of freer multilateral trade that has served it well since the inception of the GATT.

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## Introduction

The December 1990 retreat from the Uruguay Round of trade negotiations under the General Agreement on Tariffs and Trade (GATT) has put a successful conclusion of the Round in doubt. But with U.S. President George Bush having obtained an extension (until May 31, 1993) to his "fast-track" negotiating authority, talks among the GATT contracting parties will now effectively revive. Nevertheless, signs of agreement on substantive issues before the new, self-imposed, December 1991 deadline remain few.

For Canada, a second-tier economic power, a new multilateral agreement would be a movement toward stability in trade relations: a global set of rules on trade gives much greater scope to countries like Canada for having their grievances dealt with than the size of their economies alone would give rise to. As well, since regional trade agreements must be consistent with GATT obligations, any meaningful progress in the Uruguay Round would facilitate the success of talks on a North American free trade area, which Canada is now negotiating.

It is therefore natural that a successful conclusion to the Uruguay Round be a priority of Canadian trade policymakers. Still, even if a meaningful GATT agreement is achieved, the trend of regional market integration ("trade blocs") and the increasingly unilateral approach to trade issues by some major players (most notably the United States and Europe) will likely not be reversed. While any failure of the Uruguay Round would clearly accelerate these trends, large and perhaps growing elements of uncertainty will remain in global trading relations no matter what the outcome of the talks.

In this context, the Canada-U.S. Free Trade Agreement (FTA) can be seen as an anchor of *relative* stability in Canada's trade outlook, building upon the benefits of participation in the GATT. Despite the FTA, however, Canadian producers are still far from having secure and nondiscriminatory access to their most important foreign market, the United States. Furthermore, freer trade between Mexico and the United States leaves Canada at risk of losing some of its FTA preferences in the U.S. market.

In light of these unfolding developments, and with Chapter 19 of the FTA committing Canada and the United States, by the end of 1995 at the latest, to "a substitute system of rules for dealing with unfair pricing and government subsidization," a review of Canada's trade options is in order.

This *Commentary* argues that the focus of trade strategy should continue to be enhanced access to the U.S. market for Canadian producers, and that this strategy is consistent with Canada's long-term interest in and pursuit of multilateral trade agreements and enhanced competitive ability.

The *Commentary* reviews the issues pending in the Uruguay Round; the emerging shape of world trading relationships; the experience of the FTA to date — and particularly the dispute settlement process. It then draws on these observations to define a 1990s trade policy agenda for Canada, focusing on some unfinished business in the Canada-U.S. FTA.

## Canada in the Uruguay Round

### *A Brief Overview of the Round*

Since 1986, the Uruguay Round of GATT negotiations has been hampered by major obstacles to agreement among the major trading powers (the United States, the European Community [EC], and Japan) — and among the GATT's more than 100 contracting parties. The difficulties can be attributed, in part, to the sheer scope of the discussions. The current Round encompasses a greater set of issues than were discussed in any of the previous seven rounds. This ambitious agenda was set up partly to get every participant, including the less-developed countries, to commit to successful negotiations; *quid pro quos* had to be found, broadening the scope of the talks.

A more fundamental reason for the ambitious scope of the Uruguay Round is the great change in the nature of international economic relations since the late 1970s. Among the most significant of these changes are the rapid growth of trade in services, the explosion of crossborder direct investment, and the emergence of the EC as an agricultural exporter. The GATT risked losing much of its relevance if these new elements and a widening array of unfair trade practices could not be brought under its umbrella.

Thus, in addition to tackling the difficult questions of trade liberalization for agricultural goods and textiles, the GATT negotiators are trying to set up rules for trade in services and to address new issues of trade-related investment measures — for example, requirements for export performance and local content levels — and the protection of intellectual property. A further important objective is the strengthening of the GATT itself, particularly as it relates to dispute settlement.

Since all the negotiating issues are inextricably intertwined, it is not surprising that one major sticking point, the issue of agricultural trade liberalization, has been enough to jeopardize the whole process. The United States and the Cairns Group of agricultural exporters, on the one hand, and the EC on the other, remain far apart on a timetable and on the amount of subsidies to be cut back.

In January 1991, the Commission of the EC put forward a proposal aimed at reforming the Community's Common Agricultural Policy. If adopted, the new plan would allow the Community to table an improved agricultural position at the GATT negotiations. The problem is that, if left to the ordinary negotiating process among EC member states, formal adoption of the plan will not likely come before the end of 1991. This would postpone any chance of a solution until 1992, an election year in the United States. In order not to shatter the GATT, the EC may need to develop its own "fast-track" procedure to give its negotiators the flexibility to conclude deals and to bypass internal squabblings.[1] This development would require a degree of political will lacking so far to see the Uruguay Round succeed.

## *Canada's Priorities in the Round*

Canada's priorities in the Uruguay Round can be arranged under three headings: strategic, sectoral, and institutional. Given the upcoming Canada-U.S.-Mexico trade talks, one of Canada's major *strategic* objectives is to make its positions on bilateral Canada-U.S. concerns — for instance, on subsidy negotiations — acceptable in principle at the multilateral talks. If the Canadian position on a given issue gets wide enough consensus at the GATT, this would provide a platform from which to advance Canada's North American interests on the same issue.

As for Canada's *sectoral* priorities at the GATT, it is clear that agriculture dominates. As a member of the Cairns Group of agricultural exporters, Canada has participated in attempts to get the EC to reduce its farm — in particular, grain — subsidies. As an efficient grain producer lacking the resources to fight a major international subsidy war, Canada's interests are clear. Somewhat paradoxically, Canada is also seeking to preserve the protection it accords its dairy and poultry farmers through marketing boards. It will also want to ensure that some of the protection accorded to its cultural subsidies under the FTA is not eroded by a new international agreement.

At the *institutional* level, Canada has a vital interest in strengthening both the GATT antidumping and countervail agreements and its dispute settlement mechanism.

## *The Limits to GATT*

Whether or not Canada achieves its objectives in the Uruguay Round, any GATT agreement is unlikely to eliminate all or most discriminatory barriers faced by Canadian exporters. Even if measures to limit the unfair application of antidumping, and an improved subsidies code — which would circumscribe the application of countervailing duties and some mea-

sure of codification over new "gray area" protectionism — become part of new global deal, it is well to remember that the GATT does not challenge the right in principle of contracting parties to impose such measures. Countries that seek secure access to large "level playing fields" must look beyond the GATT to regional or bilateral arrangements to realize their objectives more fully.

## The Emerging World Trading System

### *The Diminishing Reach of Rules-Based Behavior?*

The 1980s saw a renewed expansion of world trade, at rates substantially exceeding overall economic growth, but a rapid restructuring of economies has also seen the emergence of trade tensions. The use of protectionist measures — whether European antidumping actions aimed at Asian producers, U.S. countervailing actions, or "voluntary" export restraint arrangements (VERs), to mention some of the most prominent — rose through most of the decade.

Not all the changes of the past few years have been in the direction of protectionism. There have also been significant movements toward greater liberalization, notably in Japan and other Southeast Asian countries, and in some Latin American countries. Global liberalization in the financial sector — including reduced control on capital flows and ownership rules — has contributed to more open exchanges. Furthermore, GATT-consistent arrangements to free up trade within limited areas, or blocs, have flourished. Examples include the Single European Market, the Canada-U.S. FTA, and the Australia-New Zealand Closer Economic Relations Agreement. Although each of these blocs has the potential to curb trade with countries outside the group, and can divert bloc members' attention away from global trade liberalization, their rules-based structure is such that they could eventually form the building blocks of a more integrated global trading system.

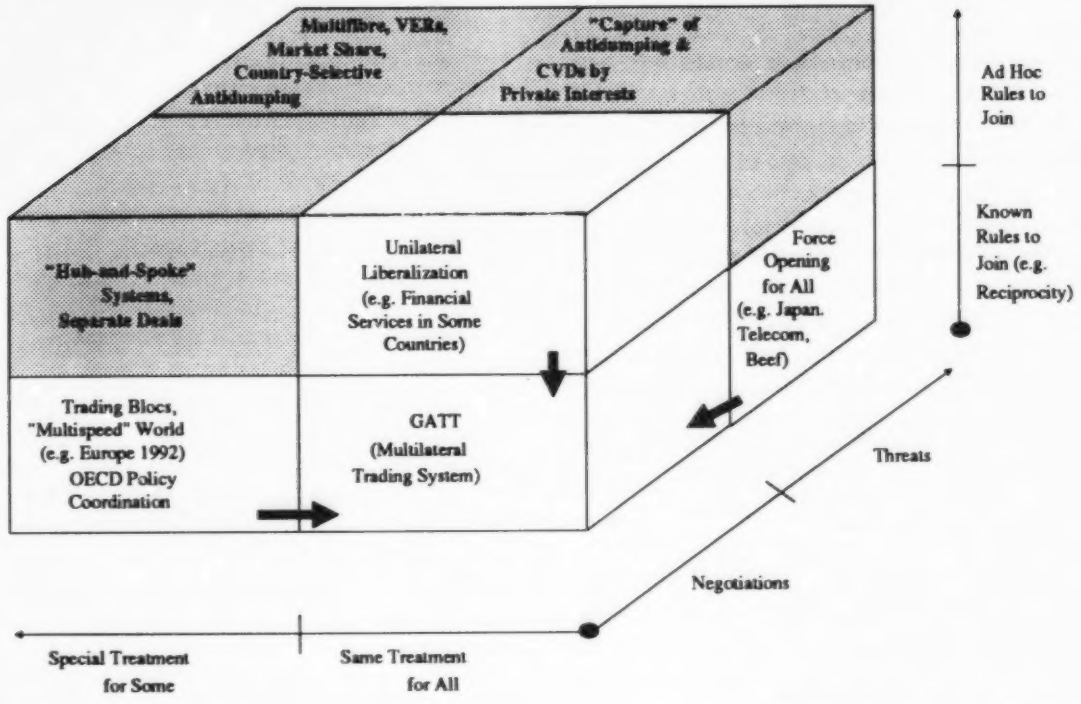
In an environment of free capital flows, furthermore, it is difficult — though by no means impossible — to keep foreign competitors out of the home market. Thus, the record crossborder investments of recent years continue to create a powerful force toward global economic integration despite the creation of blocs. Indeed, even though they are much talked about, the impact of trade blocs on world trade flows was matched through much of the 1980s by strong expansions in interbloc trade as well.

On balance, however, despite some positive developments, a troubling picture emerges from recent trends in world trade. Given the numerous instances of trade disputes and trade liberalization bypassing the multilateral GATT dispute settlement and negotiating routes, the door has been opened to the use of unilateral threats of retaliation to force foreign markets open.

Unilateral and threat-based trade policies can imperil the entire global trading system. Even though these policies have successfully opened markets from time to time, they can just as easily become hostage to the domestic political process, which may then increasingly push for unilateral action or bilateral "deals" detrimental to the interests of third parties — and which cannot subsequently be integrated into a multilateral framework, since they entrench constituencies that will oppose further trade liberalization (see Figure 1). Contrast, for example, the opening of the Japanese beef and telecommunications markets — which benefits all importers to Japan — with the 1986 U.S.-Japanese deal on semiconductors — which, by specifying a share of the Japanese market for U.S. producers, is incompatible with global trade liberalization.

If the Uruguay Round fails, the threat-based approach to trade relations will likely become increasingly unrestrained and captured by special interests. In turn, this would tend to reinforce interbloc protectionism, as well as enhancing the role of trade blocs as the

**Figure 1:** ***Global Trade Integration***


Multifibre, VERs, Market Share, Country-Selective Antidumping
"Capture" of Antidumping & CVDs by Private Interests
Ad Hoc Rules to Join
Known Rules to Join (e.g. Reciprocity)
"Hub-and-Spoke" Systems, Separate Deals
Unilateral Liberalization (e.g. Financial Services in Some Countries)
Force Opening for All (e.g. Japan, Telecom, Beef)
Trading Blocs, "Multispeed" World (e.g. Europe 1992) OECD Policy Coordination
GATT (Multilateral Trading System)
Threats
Negotiations
Special Treatment for Some
Same Treatment for All

Developments in the white blocks can eventually be integrated into a global trading system based on known, negotiated rules applying to all participants (such as epitomized by the GATT), because while they occur outside such a system, they are not fundamentally inconsistent with it. Developments such as those shown in the shaded blocks are not compatible with a GATT-like system because they create constituencies specifically opposed to it.

main providers of reliable, rules-based trading environments for nations belonging to such groupings.

## *The Impact on Smaller Economic Powers*

Second-tier economic powers do not have an inherently strong negotiating position, so these smaller economies will continue to have the biggest stake in maintaining an effective set of global trade rules. Nevertheless, the evolving challenges posed by protectionism, freer capital flows, costlier technologies, the need to access lower-cost inputs, increased intra-industry specialization, and the creation of integrated regional economies require moves by peripheral countries that go well beyond an exclusive reliance on the GATT, which alone can deliver only imperfect market access.

Nowhere is this dynamic more evident than in Europe. The EC has always been highly protectionist toward nonmembers. Analysts are divided about whether these barriers have, overall, been raised in the process of completing the European Single Market. It is clear, however, that Europe's new economic dynamism has raised the cost of the existing barriers for non-Community members, prompting many of them to want to become insiders, or to be considered as such.

In particular, nations peripheral to the EC have found it in their interest to increasingly

**Table 1: *Sweden and Canada: Adapting to Global Competition***

*The External Environment*

| | Sweden | Canada |
|---|---|---|
| Main trading partner | EC | U.S. |
| Share of exports to main trading partner (1989) | 53% | 73% |
| Real effective exchange rate (appreciation since 1985) | +20% | +36% |
| Net direct investment flows, 1985–90 (US$) | –$27 billion | –$9 billion |

*Comparisons with Main Trading Partner*

| | Sweden | EC |
|---|---|---|
| Economic growth, 1985–90 annual average (%) | 2.1 | 3.0 |
| Inflation rate, 1985–90 annual average (%) | 6.4 | 4.5 |
| Government spending as % of GDP 1988 | 59.6 | 48.1 |
| GDP per capita, 1989 (US$) | $22,300 | $14,900 |
| | **Canada** | **United States** |
| Economic growth, 1985–90 annual average (%) | 3.4 | 2.9 |
| Inflation rate, 1985–90 annual average (%) | 4.4 | 3.9 |
| Government spending as % GDP 1988 | 44.4 | 36.3 |
| GDP per capita, 1989 (US$) | $21,000 | $20,800 |

*Recent Policy Trends*

| | Sweden | Canada |
|---|---|---|
| Real short-term interest rates, 1985–90 | 5.0% | 5.8% |
| Fiscal policy (central government) | VAT raised to 25% | 13.5% manufacturers' sales tax replaced by 7% GST |
| | Lower marginal income tax rates (personal and corporate) | Lower marginal income tax rates (personal and corporate) |
| | Broader tax bases | Broader tax bases |
| Trade policy | European Economic Space talks (1989) | Canada-U.S. Free Trade (1989) |
| | Announces will seek EC membership (1990) | North American free trade talks (1991) |

Sources: International Monetary Fund; Organisation for Economic Co-operation and Development; Statistics Canada.

adapt their policies to those of EC members, and in many cases have expressed interest in membership. Thus, Turkey, Cyprus, Austria, and Sweden have applied or will apply to join the Community. Norway has pegged its currency to the ECU and will likely hold a referendum on Community membership by the mid-1990s. Other countries of the European Free Trade Association (Switzerland, Finland, Iceland) are negotiating with the Community to expand on basic free trade agreements that have been in effect between them since 1972. Meanwhile, the re-emerging market economies of Eastern Europe are trying to gain greater access to the EC, and the consequent need to adapt their economic policies will be an important element of reform in that region.

The case of Sweden is illuminating in this context. It continues to retain an expensive set of social measures, and as a result is the

highest-taxed member of the Organisation for Economic Co-operation and Development (OECD) country. While it intends to uphold its social policies, Sweden has had to change its strategy dramatically to ensure continued high standards of living. Elements of the new growth policies adopted by the Swedish government include a fixed exchange rate *vis-à-vis* a basket of currencies, harmonization of industrial standards with those of the EC, and lower personal and corporate income taxes — but higher consumption taxes (see Table 1). Sweden has recently indicated that it would apply for EC membership.

The reasons for this turnaround from the policies Sweden pursued only a few years ago are manifold. They include the disincentive effects of high tax rates on Sweden's economic performance — one of the worst growth rate among OECD countries in the 1980s — but also the competitive challenge posed by the combination of greater European integration, freer capital flows, and Eastern European political changes. Over the past few years, Swedish firms have been meeting these competitive challenges by making massive direct investments outside of Sweden.

## *U.S. Trade Policy*

To assess the environment for Canada's trade policy in the 1990s, one must take into view not only the global trading context but, more specifically, the trade policies of the United States. The aims of U.S. policymakers through the next presidential election in 1992 and beyond will have a decisive influence on the type of trade deals that will be negotiated at world and North American levels.

In this respect, the application of U.S. trade remedy laws sharply increased in the 1980s. There is evidence that U.S. antidumping and countervail measures have targeted imports that were growing due to their competitiveness rather than as a result of any unfair trading practices. Along the same line, the United States negotiated VERs with its trading partners in order to limit imports of certain competitive products — for example, in the steel and auto industries. At the same time, the 1988 *Omnibus Trade Act* contained the Super 301 section, which mandated the administration to identify and take action against unilaterally identified "unfair traders." Most disturbing of all, measures have recently been taken subjecting foreign investors in the United States to tighter government supervision, and there are ongoing pressures in Congress for outright limits on foreign direct investment.

There are various causes for these developments. The official U.S. line is that a tough stance — including the threat of retaliation — must be taken in bilateral talks to remove ill-defined "unfair" trade barriers against U.S. products. At the industry level, there is a growing understanding of how trade remedy laws — which, in principle, are GATT-legal but can be applied with much latitude by the importing country — can boost protection *vis-à-vis* successful competitors. Perhaps most perniciously, there has been a growing intellectual argument that, since foreign competitors are deemed to have obtained unfair advantages — subsidies, protection in their home market — that have allowed them to penetrate the U.S. market, this justifies equivalent U.S. protection and/or the automatic use or threat of unilateral retaliation in order to remove the foreign barriers.

Even in the event of a GATT agreement, it is unlikely that the protectionist forces in the U.S. Congress will disarm rapidly, particularly as the U.S. economy will continue to feel the impact of the current recession for some time to come and as the 1992 electoral contests loom. By virtue of the FTA's anti-sideswipe provisions and binational panel review, among other things, Canada will to some extent be sheltered from further protectionist measures arising in the United States. It would, however, be worthwhile for Canada to try to further increase its security of access as a preventive measure against additional U.S. protectionist swings.

***The Extraordinary Challenge on Pork***

Following the decision by the Extraordinary Challenge Committee set up under the terms of the Canada-U.S. FTA to deal with the bilateral dispute over pork trade, the countervailing duty (CVD) order applying to Canadian pork entering the United States has been revoked. In addition, some $20 million in duties paid since 1989 are to be refunded. What were the factors behind this ruling and what is its significance?

The duties were initially imposed after the U.S. Department of Commerce found that the Canadian pork industry was subsidized, and the U.S. International Trade Commission (ITC) ruled that Canadian imports were threatening injury to the U.S. pork industry (both subsidization and injury must be shown before countervailing duties can be imposed). Canada challenged both decisions, which, under the terms of the FTA, were then referred to binational panels.

The Commerce Department's decision went before the FTA panels twice, eventually resulting (on April 11, 1991) in reduced duties on Canadian pork on the panel's instructions. A separate FTA panel reviewed the ITC's decision, which was based on the threat of *future* injury to the U.S. pork industry, and remanded the ITC's ruling for reconsideration. Subsequently, the panel directed the ITC to rule negatively on the issue of *existence* or threat of injury, which it did. It is this remand that U.S. Trade Representative (USTR) Carla Hills appealed, through the use for the first time of the extraordinary challenge procedure under the FTA.

This procedure can be invoked under the following conditions (spelled out in paragraph 1904.13 of the FTA): a Party to the Agreement must allege (a) either that (i) a member of the panel was guilty of violating the rules of conduct — for instance by being in a serious conflict of interest, or (ii) that the panel seriously departed from a fundamental rule of procedure, or (iii) the panel manifestly exceeded its powers, authority or jurisdiction; and (b) that the aforementioned actions materially affected the panel's decision and threatened the integrity of the binational panel review process. In this particular case, the United States invoked article 1904.13 (a) (ii) *and* (iii).

An Extraordinary Challenge Committee was then formed, with Canada and the United States each selecting one member from a ten-person roster comprised of judges and former judges. A third member, in this case a Canadian, was selected by the other two. In its decision, the Committee unanimously upheld the FTA panel's decision, by rejecting the grounds on which the Trade Representative moved in April 1991 to submit a panel decision on Canadian pork to the FTA's extraordinary challenge procedure (see box above).

## The Experience of the FTA

### *The FTA Two Years After: Implementation*

After little more than two years, most of the provisions of the FTA seem to have been implemented relatively smoothly, at least from a technical point of view. At the request of industry, there have already been two rounds of tariff eliminations ahead of the FTA schedule. The institutional provisions of the Agreement have also been functioning well overall. The two cases to have come before binational dispute resolution panels set up under Chapter 18 — for disputes of interpretation or implementation — have generated some controversy. At the time, however, Chapter 19 FTA panels — on countervailing and antidumping cases — have dealt with 15 cases without hitting a serious snag — that is, until the U.S.

Because these panels constitute a novel experiment in trade dispute resolution and hold some valuable lessons for future trade policy, their impact is examined in some detail below. In general, trade tensions between Canada and the United States seem to have been lowered since the FTA entered into force,[2] despite heightened friction between the United States and many of its other trading partners.

It also appears that Canada will be able to reap more fully the benefits of Chapter 17 of the FTA on financial services, if the recently announced reform of the U.S. banking system — eliminating most geographical constraints on commercial banks, reducing barriers to competition among various types of institutions, and strengthening capital requirements

***The Extraordinary Challenge on Pork (continued)***

U.S. administration appealed to the extraordinary challenge procedure. In the strong words of the Committee, "the 'extraordinary challenge' procedure is not intended to function as a routine appeal. Rather, the decision of a binational panel may be challenged and reviewed only in 'extraordinary' circumstances."

It was widely agreed that there were indeed no reasons to doubt the propriety of the process surrounding the binational panel decision that gave rise to the challenge and, hence, that the circumstances surrounding that decision were not "extraordinary". Why then was the challenge procedure invoked? This move by the USTR came at a time when the U.S. administration was seeking from Congress an extension to the "fast track" negotiating authority, in order to proceed with the Uruguay Round and talks on a North American Free Trade Area (NAFTA). It appears likely that the USTR found it more expedient to take an unfair stand against Canadian interests rather than risk alienating members of Congress who were under pressure from U.S. pork producers for protection from Canadian imports.

What are the main consequences of the Committee's ruling? First, by restoring the integrity of the panel system, it reinforces the panels' final decisionmaking role under normal circumstances. Although some U.S. industries may well press for continued use of the procedure as a means to harass competitive Canadian producers, the limits of such harassment are now better defined, which would have the effect of discouraging it in the future. Thus, it is a concrete step toward better access to the U.S. market for Canadian-based producers. Second, the demonstration that the FTA challenge procedure cannot be used to overturn panel decisions whenever politically convenient will have an impact on the NAFTA talks. While it will, of course, make the United States less eager to submit to a similar dispute resolution mechanism in a trilateral context, the ruling will give NAFTA participants — in particular, Mexico — a clearer sense of the workings of such a system and what they should be aiming for in the negotiations.

Despite the favorable ruling, Canada must continue to be vigilant and press for even stronger protection from arbitrary U.S. actions. Indeed, U.S. pork producers have made it clear that they would jump at the opportunity to renew their attacks on Canadian imports, if market circumstances changed sufficiently for them to launch another case. A further strengthening of the appeal process — for instance, by making the cost of the extraordinary challenge fall on the complainant when the committee upholds the original panel's decision — would be a valuable goal for Canada in upcoming negotiations with the United States.

— proceeds along the lines proposed by the U.S. Treasury in February 1991. With these reforms, Canadian and U.S. financial institutions will be put on a more equal footing in their ability to pursue opportunities in each others' home market.

## *The FTA Two Years After: What Can We Say About the Impact?*

There is no doubt that the FTA has added to already strong pressures on Canadian firms and workers to adjust to heightened global competition. These difficulties have been compounded by the recession that began in Canada and the United States in 1990. There is now evidence, at least in Ontario, of ongoing structural change as the numbers of permanently laid-off employees in 1989 and 1990 represent a far greater share of total layoffs than had been the case in the 1981–82 recession.

Nevertheless, it is overly simplistic — and ultimately incorrect — to blame most or even a large proportion of the recent job losses in the Canadian economy on the FTA. The 1990–91 job loss data for Ontario, pointed to by the antagonists of free trade, also show that a growing trend toward "structural" job losses has been in place since the mid-1980s, although this was offset by employment gains in an expanding economy. As well, throughout the current downturn real interest rates have been higher, the Canadian dollar has been stronger, and fiscal policy has been tighter than during the 1981–82 recession suggesting that the macroeconomic policy environment has been far less supportive of the economy this time around — and hence takes a larger part of the blame for the downturn.

**Table 2:** ***Canadian Exports: Changes in the First Two Years of the Free Trade Agreement***
(C$ billions)

| | 1988 | 1990 | % change |
|---|---|---|---|
| Exports to United States | 97.5 | 105.1 | 7.8 |
| Exports to other countries | 36.3 | 35.9 | -1.3 |
| **Goods not affected by FTA (including goods for which exports to the United States are a very small share)** | | | |
| Wheat | 4.6 | 3.4 | -25.6 |
| Steel* | 2.4 | 2.5 | 3.1 |
| Other metals | 6.8 | 6.6 | -3.2 |
| Lumber | 5.4 | 5.2 | -3.2 |
| Pulp | 6.4 | 5.9 | -6.9 |
| Newsprint | 7.6 | 6.2 | -18.2 |
| Coal | 1.5 | 1.7 | 9.0 |
| Electricity | 0.9 | 0.5 | -39.8 |
| Other materials* | 7.6 | 7.4 | -1.6 |
| Agricultural machinery | 0.7 | 0.9 | 27.1 |
| Aircrafts | 3.1 | 4.6 | 50.7 |
| *Total* | *47.0* | *44.9* | *-4.5* |
| **Goods affected by FTA (excluding petroleum)** | | | |
| Food* | 7.2 | 7.6 | 6.2 |
| Alcoholic beverages | 0.5 | 0.7 | 33.8 |
| Natural gas | 3.0 | 3.2 | 8.0 |
| Crude wood | 0.4 | 0.3 | -26.2 |
| Other wood* | 1.1 | 1.1 | -4.1 |
| Other paper | 1.3 | 2.1 | 63.1 |
| Chemicals | 4.1 | 3.7 | -10.1 |
| Other materials* | 10.0 | 11.0 | 9.9 |
| Autos and parts | 33.6 | 33.9 | 0.7 |
| Machinery and equipment | 16.7 | 21.1 | 26.1 |
| Other end products | 5.1 | 5.0 | -1.9 |
| *Total* | *83.0* | *89.7* | *8.1* |

*Certain components only.

Totals may not add up due to rounding.

The table indicates that there were many significant factors behind the poor Canadian export performance over the past two years which had nothing to do with the Free Trade Agreement. (However, we cannot infer from the table that the FTA actually helped increase exports.) Petroleum and petroleum products were excluded because of the distorting impact of the Gulf War.

Source: Statistics Canada, *Summary of Canadian International Trade*, Cat. no. 65-001, December 1990.

Canada's balance of payments data over the past two years fail to support the contention that the FTA has caused a net decline in Canadian industrial activity. Three points are worth making. First, net direct foreign investment in Canada has risen to an all-time high of $4.3 billion in 1990, compared with a net investment *outflow* of $2.5 billion in 1988, before the FTA took effect. Second, the value of Canada's exports to the United States has increased by 8 percent over the two years since the FTA took effect. Canada's exports to the rest of the world, in contrast, have declined over the same period. Meanwhile, Canada's imports from the United States have grown only slightly faster than nonenergy imports from other countries indicating little increased propensity by U.S. producers to penetrate the Canadian market. Third, since 1988, Canada's exports have performed more poorly in sectors that were *not* affected by the FTA, declines that can therefore hardly be explained by the Agreement (see Table 2).[3]

## *The FTA's Dispute Settlement Mechanisms: Canada's Loss or Gain?*

The FTA provides for two types of dispute settlement panels. Chapter 18 sets up panel proceedings with a binding arbitration mechanism to settle disputes between the parties on the interpretation and application of most FTA provisions — the two exceptions are financial services and settlement of disputes in antidumping and countervailing duty cases. Under Chapter 19, binational panels are set up to deal with disputes arising out of antidumping and countervailing duty cases. This mechanism was set up when it became clear that it was not possible, within the time frame of the FTA negotiations, to agree on a mutually acceptable way of dealing with subsidies and unfair pricing. Such negotiations, ideally, would have released Canadian producers from the application of U.S. trade remedy laws.

It is clear that the Chapter 19 panels were not meant, nor are they empowered, to shelter any firm from either country's trade remedy laws. What the mechanism of a binational panel allows is the review of whether trade laws in either country have been fairly applied — that is, not arbitrarily or for harassment purposes.

A judgment on the working of the panels has to be set against what they were meant to accomplish. On that basis, in the course of their short history, the FTA's dispute settlement processes have proven that they can provide a measure of protection against arbitrary applications of U.S. trade laws. Contrary to some perceptions, Canada has often benefited from FTA panel decisions that have reversed or softened determinations of U.S. trade authorities. Furthermore, in only one case did the panel split clearly along national lines (see Table 3). Thus impartiality of the panels does not seem to be in question. These precedents of unanimous panel findings may well discourage biased decisions against Canadian producers in the future, saving producers the cost of defending themselves against frivolous complaints.

In a decision handed down in January 1991, a Chapter 19 binational panel ruled favorably for Canada in the "fresh, chilled, or frozen pork case." This panel found that the U.S. International Trade Commission (ITC) did not back up with sufficient evidence its finding of a threat of injury to the U.S. pork industry from Canadian imports. (The ITC had already refused to accede to a previous binational determination, but this most recent decision by the FTA panel nevertheless has forced it reluctantly to back down on this issue.) In terms of annual trade — $375 million worth of exports in 1989 — this case is the most significant to be heard before FTA panels so far.

While the pork case saw an extraordinary challenge by the U.S. administration, apparently on mostly political grounds (see box on pages 8 and 9), the recent unanimous committee decision to uphold the panel's finding has basically reaffirmed the worthiness of the binational mechanisms set out in the FTA.

**Table 3:** ***Canada's Trade Scorecard: Chapter 19 Panel Decisions Involving U.S. Countervailing Duty (CVD) and Antidumping (AD) Actions Against Canadian Producers***

| Case | Decision | Changes Favoring Canada | Panel Unanimity |
|---|---|---|---|
| Red raspberries (AD) | U.S. Commerce Department methodology should be based on price | Margins removed for two out of three complainants | Yes |
| Paving equipment parts (AD, 3 cases) | U.S. antidumping action judged proper | None | Yes |
| Codfish (AD) | None — action taken before panel hearing | U.S. revoked antidumping order | Not applicable |
| Pork (CVD) | Countervail determination by U.S. must be reconsidered | Reduced duties | Yes |
| Steel rail — Sysco (CVD) | Duty imposed by U.S. Commerce Department remanded for recalculation | Reduced duties | Yes |
| Steel rail — Algoma (AD) | Panel affirmed use of information by U.S. administration | None | No |
| New steel rails (AD, 2 cases) | Panel affirmed ITC's decision that Canadian imports were threatening U.S. industry | None | Yes |
| Pork (CVD) | Panel twice remanded to ITC to reconsider threat of material injury; U.S. launches extraordinary challenge under FTA | Extraordinary Challenge Committee rules no basis for appeal; duties removed | Yes |

In spite of the progress the panel process represents, it should be kept in mind that it was originally devised as an interim mechanism. Ultimately, as we will see in the following section, even if Canadian producers played by the same pricing and subsidy rules as their U.S. competitors, they could still, under existing trade regimes, face antidumping and countervailing duty actions based on the sole fact that they are located in Canada — likewise, U.S. producers could face similar barriers in the Canadian market. Thus, the goal of "secure access", or of a level playing field in the U.S. market for Canadian firms, is far from fact, something to which critics of the FTA have often, and rightly, drawn attention. This shortcoming points to the need for vigorous pursuit of the United States on a second round of trade negotiations.

## A Trade Agenda for the 1990s: Securing Market Access

### *The Need to Focus on the Canada-U.S. Trade Relationship*

The globalization of production and investment, the challenges of new technologies, the trend toward greater regional economic integration, and the heightened use of trade remedy laws for blatantly protectionist purposes have made it imperative for medium-sized economic powers to enhance their security of access to larger markets. Indeed, securing a level playing field, where one's domestic production will exchange on equal terms within a sufficiently large market, in many respects commands a higher priority than an improved but still imperfect access to the global market.

A primary objective of Canadian trade policy should be to continue to improve and to secure the access of Canadian-produced goods and services to the United States.

Some observers have deplored such a focus on the U.S. market. It is sometimes suggested that Canadian trade policy and Canadian firms should concentrate their marketing and other trade-enhancing efforts *proportionally more* on faster growing markets — in Asia, in particular — if only to avoid overdependence on the U.S. market. While this may well be optimal for certain product lines, a simple calculation suggests that focusing less on the U.S. market may not be appropriate as an overall trade strategy.

Consider a scenario in which Canada increases its share of the U.S. import market by 1 percentage point overnight, the equivalent of a 5 percent expansion of the volume of Canada's current exports to the United States. Then assume that the U.S. import market grows by 2.5 percent annually in volume over the next ten years. Canada's annual exports to the United States would then increase by approximately $32 billion (in today's dollars) by the end of the decade.

Compare this with another hypothetical scenario in which Canada increases its share of the Asian import market by 1 percentage point overnight — equivalent to a dramatic 25 percent increase in the current level of Canadian exports to Asia. Then assume the Asian import market subsequently grows by 7.5 percent per year in volume terms over the next ten years. Canada's annual exports to Asia would then rise by about $22 billion by the end of the decade.

Clearly, the positive impact on the Canadian economy of a 1 percent increase in market share in the United States is, all else being equal, much greater than that of a 1 percent increase in market share in Asia. The first strategy would generate 40 percent more in new annual export revenues than would the latter, even assuming another decade of fast growth rates in the Asian market.[4]

## *The U.S. Market and Canada's Competitiveness*

As is fairly well known, but not always appreciated, the United States is the only major market to which Canada does not overwhelmingly export raw or semi-processed materials. Even when the automotive sector is removed, this remains true by a significant margin (see Table 4). Europe and Asia, by contrast, import relatively little in the way of Canadian manufactured goods.

There is here at least a presumption that securing Canada's trade relationship with the United States would likely mean higher value-added exports than a disproportionate concentration on overseas markets. As well, success in the U.S. market improves a Canadian firm's visibility and competitiveness, and can be an important key to success in overseas markets as well. This does not necessarily result in an increased Canadian economic "dependence" on the United States — something for which there does not seem to be much evidence. In many ways, the United States is Canada's first line of attack in cutting its teeth on "global" competitiveness.

While these observations are certainly not new, they are worth reiterating in view of the renewed emphasis in policymaking circles on the link between standards of living and competitiveness. Recent work on this issue by Alan Rugman and Joseph D'Cruz of the University of Toronto has sought to adapt the paradigm developed by Michael Porter of Harvard University to the Canadian context.[5] In this framework, Canada's competitive position can be explained in terms of Porter's four determinants, "diamond" factor conditions, demand conditions, supporting industries, and firm and industry structure.

This line of analysis suggests that Canadian firms become more competitive when they consider the U.S. market as their *domestic* market. There are two reasons for this. First, U.S. customers represent a higher volume and are seen as more demanding than the Canadian ones, thereby providing a stronger

**Table 4:** ***Share of Resource-Based and End-Product Manufactured Exports to Selected Destinations, 1989***
(percentage)

| Destination | Exports, Including Autos | | Exports, Excluding Autos | |
|---|---|---|---|---|
| | Resource-Based Goods | End-Product Manufactures | Resource-Based Goods | End-Product Manufactures |
| United States | 47% | 53% | 72% | 28% |
| Western Europe | 77 | 23 | 79 | 21 |
| Far East | 89 | 11 | 90 | 10 |
| Others | 76 | 24 | 79 | 21 |
| Total | 57 | 43 | 76 | 24 |

Source: Statistics Canada, *Exports, Merchandise Trade*, Catalogue 65–202, 1989.

incentive for their suppliers to innovate. Innovation, in turn, is seen as the key to sustaining a firm or industry's competitive position. Second, while each individual business may naturally be wary of the changes required to adapt to the more competitive market, if substantially all of the economy is engaged in the same exercise, then the "supporting" industries for each of the major Canadian industrial clusters (a set of firms, customers, and suppliers) will also realize that they are competing in a wider market and will also adopt a North American outlook to innovation and growth. This in turn will benefit Canadian firms depending on these supporting industries. According to this view, increased openness toward the U.S. market would therefore strengthen two of the four sides of the Canadian firms' competitiveness diamond.

The conclusion to be drawn from these findings seems to be that Canadian producers need even broader and more secure access to the U.S. market. The more its mindset moves to the United States as its "home" market, the better Canadian industry will be able to build on the gains expected from the FTA and expand into overseas markets. The set of issues that need to be dealt with to achieve that goal constitutes, in a broad sense, the "unfinished business" of the FTA, to which I now turn.

## *Unfinished Business in the Canada-U.S. FTA*

Apart from the lowering of tariffs, which is part and parcel of any free trade agreement, the Canada-U.S. FTA was an attempt to deal in novel ways with recently emerging issues such as trade in services, dispute settlement, and trade-related investment measures. Nevertheless, the Agreement fell short of a framework whereby protection from discriminatory measures was accorded in either country to goods (and services) produced in the other. In this context, Article 1907 of the FTA commits the parties to seek "to develop more effective rules and disciplines concerning the use of government subsidies" and "to develop a substitute system of rules for dealing with unfair pricing and government subsidization."

In Chapter 19, the two countries agreed that these negotiations should be concluded by January 1, 1993, and no later than January 1, 1995, failing which the Chapter 19 provisions would lapse and either party would be allowed to terminate the agreement on six-months' notice. Canada has chosen to delay formal bilateral negotiations with the United States, although the Canadian and U.S. delegations have obviously been exchanging views at the GATT talks on these very same issues.

The rationale for postponing negotiations on the FTA's "unfinished business" until the end of the GATT talks is that, since the Uruguay Round would likely make substantial progress on strengthening the GATT Subsidies Code, and also change GATT articles affecting antidumping, Canada and the United States could then take these issues on bilaterally by building on the hoped for multilateral agreement. Indeed, the possibility that Canada can improve access to the U.S. market via a successful Uruguay outcome is a measure of how high the stakes are for Canada in the multilateral round.

Formal negotiations on a new Canada-U.S. deal ideally should begin soon after the conclusion of the Uruguay Round. Since, as I argue below, it is unlikely that the talks on a North American free trade agreement (NAFTA) will provide a platform from which Canada's interests on *bilateral* concerns can be advanced, the possibility for Canada to open a separate set of negotiations with the United States on unfair pricing and subsidization, alongside or separate to the NAFTA talks, should be explored. Indeed, the window of opportunity to conclude a bilateral deal with the United States will probably be fairly narrow — after U.S. and possibly Canadian elections in the fall of 1992, and before the expiry of the "fast-track" negotiating authority at the end of May 1993. Below, I briefly summarize some of the issues as they will present themselves to the trade negotiators.

## Antidumping

The antidumping issue is, in fact, a question of national treatment: should pricing practices that would be acceptable to domestic firms become "dumping" when exercised by foreign-based producers? The United States, in particular, applies its antidumping laws to situations extending well beyond the traditional definition of dumping, which is selling in foreign markets at a price below that in the domestic market. Equivocal cost calculations have, in fact, been used to deny access to Canadian firms exercising normal pricing practices — for instance, selling below cost in *both* the domestic and export markets when demand is weak. Clearly, the threat of antidumping action based on frivolous grounds constitutes, on both sides of the border, a major impediment to one country's firms having access to the other country's market.

Both countries recognize in their domestic legislation that predatory pricing is an anticompetitive and therefore illegal practice. Thus, it should in principle be possible for each country to remove the threat of antidumping action against nationals of the other country, by subjecting them only to its competition laws. This solution — or the more thorough, but perhaps second-best option of harmonizing the two countries' competition policies — would eliminate the discrimination Canadian firms currently face in the United States when it comes to pricing practice.

While the principle seems straightforward, there would likely be strong private objections to the complete removal of these barriers on both sides of the border. If domestic competition laws became the sole regulators of cross-border *and* national pricing practices, the door would be left ajar for firms from either country to sell at a lower price in the foreign market than in the domestic market — if they felt this to be an optimal strategy, provided their aims were not predatory. While this would benefit consumers, it is likely to be unacceptable to producing interests on either side of the border.

Thus, it may well be the best that can be achieved is a system where recourse to antidumping action will still be retained by either country only to deal with cases of differentiated crossborder prices (when accompanied by the usual injury determination). The two countries would recognize each other's competition laws in alleged cases of predation. This arrangement would represent a substantial improvement, as it would leave Canadian producers free of harassment from spurious cost calculations under U.S. trade remedy law. In addition, it is possible and indeed desirable to contemplate procedural improvements —

for example, raising the minimal dumping margin below which no duty would actually be collected.

In any case, as long as trade remedy legislation continues to apply between the two countries, even in a limited way, the dispute settlement panels should be required to continue in their role of judging whether these laws are being applied fairly.

## Subsidies and Countervail

The issue of subsidies raises the question of national treatment as well. In this respect, Canadian and other foreign producers are discriminated against by U.S. countervailing procedures; in fact, because the U.S. Commerce Department determines countervailing duties only on the basis of its assessment of the subsidies given to the foreign producer. Subsidies the (domestic) complainant may have received from various U.S. governments are not taken into consideration in this process. In other words, the current determination of countervailing duties automatically assumes that the producers in the importing country, which are allegedly injured by subsidized imports, do not themselves benefit from subsidies. Obviously, this is rarely the case. Removing this double standard — for instance by using a concept of "net subsidy" in countervailing duty determination — would restore the concept of "national treatment".

Even if it were possible to apply in practice, however, the concept of "net subsidy" would not be sufficient to create a fair trading environment for Canadian firms. This is because Canada and the United States engage in very different forms of support for business. For instance, U.S. states and municipalities rely more than their Canadian counterparts on the granting of tax holidays to attract companies. Thus, at the limit, each country could consider its own practices to be perfectly legitimate, while claiming that the other's practices are subsidies. In this case, applying a net subsidy concept, while upholding national treatment, may not amount to much of a practical change toward reduced discrimination in the U.S. market.

A more substantial objective would be to have the two countries agree on a list of "acceptable" — that is, nontrade-distorting and therefore noncountervailable — subsidies and "countervailable" ones. In other words, the key would be agreement on what constitutes a trade-distorting subsidy.

There are two major hurdles to this. First, the United States would need to recognize that subsidies having an import-substituting effect are just as trade-distorting as subsidies that benefit export-oriented industries. This is significant because, given the size of its economy, many of Canada's industries have to be more export-oriented than U.S. industries.

Second, Canada proposed the "lights" approach to the classification of subsidies — red: illegal subsidies; amber: countervailable subsidies; green: legal subsidies — during the FTA negotiations but received a cold U.S. shoulder. Can we expect any change this time? At the multilateral talks, the Canadian position has a real chance of forming the basis for a global consensus on subsidies. Nevertheless, the concept of a "red" or illegal subsidy will not fly at the *bilateral* level. The United States will only agree to declare any of its subsidies illegal in the context of a global agreement where all its trading partners, and not just Canada, agreed to make similar concessions.

Thus, in bilateral negotiations on subsidies, Canadian negotiators may not do much better than reconfirm the list of "red" subsidies that will have been agreed to at the GATT. It would, though, be useful to expand the list of "green" or legal subsidies that would not risk countervailing action. Such a list could increase the degree of comfort for businesses locating in Canada.

As in the case of antidumping, it is unrealistic to expect that the ability of U.S. firms to launch countervailing duty actions will be completely removed. Although the type of cases for which countervailing actions can be launched, as well as the calculation of subsidy margins, would come under stricter rules if a

bilateral agreement were reached, any improved regime would still call for retaining the panel dispute settlement structure installed by the FTA.

Indeed, given the satisfactory workings of the Chapter 19 dispute settlement panels so far, now may be the right time for Canada to try once more to move on the largest subsidy/countervail issue between the two countries: softwood lumber. The 1986 Memorandum of Understanding on softwood lumber, which was reconfirmed in the FTA, can be terminated by either party on 30 days' notice. If Canada took such action, Canadian producers would probably be subjected to renewed countervailing duty action by their U.S. competitors. Given changes in market conditions and expectations of a fairer hearing under the panel system than in 1986, Canada should be willing to take that chance.

### *North American Free Trade*

In 1989, the Mexican and U.S. governments agreed to launch a free trade initiative. This initiative was made possible by economic policy changes implemented by the Mexican government. Mexico, since the mid-1980s, has moved to modernize its economy by reducing subsidies and reliance on a large public-sector deficit. Mexican external trade policies have also been liberalized, with Mexico joining the GATT in 1986. An attempt to ensure a measure of relief from U.S. countervail and antidumping actions against Mexican firms brought forth the U.S.-Mexico Bilateral Understanding on Subsidies and Countervailing Duty Issues (1985), followed by a Framework for Consultation agreement (1987).

Since these measures were implemented, the Mexican economy has begun to recover from the ravages caused by falling oil prices and capital flight. As well, the number of U.S. antidumping and countervail actions initiated by U.S. companies against Mexican products has been considerably reduced. (Simultaneously, there has been an increase in antidumping cases brought by Mexico against U.S. producers.)

The Mexico-U.S. initiative meant that Canadian industry would have faced increased competition in the U.S. market, just as Canada had won some measure of preferred access to that market through the FTA. Indeed, for Canada, there will probably be limited positive and immediate benefits from the trilateral talks. Not joining could bring significant costs, however, a point made in previous C.D. Howe Institute studies.[7]

Three basic costs will be avoided by full Canadian participation in the talks. First, Canada will be in a position to counter more effectively any move toward special concessions to Mexico that would put its industry at a competitive disadvantage. Second, Canadian-based producers will gain as much access to cheaper inputs from Mexico as will their U.S.-based competitors. Third, Canada's participation is important in preventing the emergence of hemispheric trade along a "hub-and-spoke" pattern, within which the United States would be the only nation to enjoy unrestricted access to all other markets in the region. A NAFTA could then become a "core" trade agreement, to which such countries as Chile, which is also seeking a free trade pact with the United States, would then have incentive to join in order to gain access to the wider market.

This being said, as its participation in the talks is essentially a response to an outside event, the question must be asked whether Canada's specific trade concerns — in particular, improved access to U.S. customers — will be addressed in trilateral negotiations. A latchkey is how far the United States and Mexico are willing to proceed on the road to trade liberalization. Mexican officials and business leaders have let it be known that, given the state of Mexico's economy and institutional constraints, it may not be feasible for Mexico to sign as comprehensive an agreement with the United States as Canada has. The most obvious example of this is the Mexican pronouncement that existing restrictions on its energy sector will not be subject to negotiations. Mexico will likely also seek to shelter

some fragile sectors of its economy — for instance, the financial services industry, and will want to maintain access to the North American market for its "maquiladora" industries. Insofar as a dispute resolution procedure is concerned, it is unlikely the United States will include in a trilateral deal anything more elaborate than the panel system agreed upon with Canada in 1987. These are only some of the elements that seem to indicate that, as far as the Canada-U.S. trading relationship is concerned, a NAFTA will not be able to accommodate major innovations beyond the current bilateral regime.

While there is always the possibility that the United States and Mexico will push for a blockbuster agreement, requiring corresponding concessions from Canada in return for the benefits of greater access to the U.S. market, overall, this seems unlikely to happen in a trilateral context, at least for some time to come.

## *Enhancing Canada's Bargaining Power*

It is clear that a major U.S. impetus toward concluding an FTA with Canada was the need to counterbalance the prevailing view in the mid-1980s of the United States as an increasingly protectionist power. The FTA with Canada also served notice that, as Europe launched its Single Market initiative, and Japan's investment in Asia grew rapidly, the United States was equally ready to strengthen regional ties.

Quite apart from the fact that the United States has already committed itself to a second round of negotiations with Canada on the FTA's "unfinished business," what will be the political incentive to ensure the success of these talks when they do take place?

It should be borne in mind that the U.S. administration's reports that periodically identify "irritants" in other countries' trade practices, including Canada's, are mandated by Congress, and do not in practice represent final negotiating positions. The United States, for example, repeatedly complains about Canada's agricultural marketing boards and protection for its cultural sector. Nevertheless, as we have seen with the FTA, there is no reason why Canada should have to bargain these policies away: the U.S. administration will be willing to conclude deals that are imperfect in its view, if they still advance overall U.S. policy objectives.

Thus, if Canada hopes to achieve all of its goals for enhanced market access, U.S. negotiators must be able to present the deal to Congress within the context of broader U.S. interests than simply a stronger trade relationship with Canada — finding new ways to overcome global structural impediments to trade. Ways of dealing with such impediments, might include:

- a commitment by both countries in an updated FTA to develop quantitative indicators of the overall degree of region- or industry-specific subsidization within their respective economies, indicators that would incorporate cash subsidies and other forms of assistance; the idea would be to limit the overall proportion of such subsidies as a share of GDP; and
- a proposal to begin discussions on the use of innovation policies and environmental regulations as trade barriers.

## *Sustaining Multilateralism*

I have argued that, from a strategic viewpoint, a renewed focus on Canada-U.S. and, by extension, hemispheric issues, seems necessary to maximize Canadian firms' access to the North American market. Such links with regional trade groupings are increasingly seen by a number of nations as necessary to sustain their *global* competitive position, and should be viewed in the same light by Canadian policymakers. Thus, while Canada will continue to have an important stake in the stability of the global trading system emerging in the 1990s, it cannot draw back from the apparent emergence of a "multispeed" trading

system, where liberalization occurs at a much faster pace within certain regions than it does multilaterally.

But Canada also has an important stake in ensuring that trade developments take place in ways that are compatible with global trade liberalization. By participating in the NAFTA talks, Canada can latch the door that would have been open for a potentially destabilizing "hub-and-spoke" system of bilateral arrangements between the United States and its Latin American trading partners. Such a system would further inhibit global trade liberalization by giving the United States an incentive to retain a privileged position with each of its individual trading partners.

To counter the forces of fragmentation in the world trading system, Canada should tenaciously promote new ways of dealing with trade problems that may not involve the GATT directly but are nevertheless "multilateral-friendly". One such approach in action was the formation of the Cairns Group, which, even though consisting of medium-sized economic powers with a fairly narrow agenda, actively promoted the search for a *global* solution to the EC-U.S. agricultural subsidy wars. Canada could also support the formation of a group, perhaps comprised of OECD and selected non-OECD countries, to deal with emerging trade issues affecting mostly relations between developed countries — notably, research and development policies and protectionism based on environmental concerns or "green" protectionism. Such approaches would bypass the current GATT process, and yet are not incompatible with keeping multilateralism on track.

## Conclusion

It is still unclear whether the Uruguay Round of multilateral trade negotiations will succeed, and within what time frame. Canada would reap long-lasting benefits from a multilateral deal — for instance, in the agricultural area — yet an agreement may not be far-ranging enough to reverse the trend toward greater regional economic integration or unilateralism in trade policy increasingly practiced by the United States. In this context, second-tier economic powers will likely continue to seek to join integrated trade blocs.

For Canada, the experience of the Free Trade Agreement, certainly with its institutional provisions, has been a qualified success. Given global trends in finance, trade, and technology, however, there is a clear need for more secure access to the U.S. market. Canada should naturally continue to focus on an enhanced trade relationship with the United States as a major policy objective. Recent research on the factors underlying the competitiveness of Canadians firms also suggests this policy orientation.

In upcoming talks with the United States, mandated by Chapter 19 of the FTA, the issue of how to remove discrimination against Canadian firms in the U.S. market, as practiced through antidumping or countervailing duty action, is slated to be addressed. While competition law may partially replace antidumping law in dealing with alleged dumped imports,

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both countries will probably retain protection against crossborder discriminatory pricing. With subsidies, it will be most important to agree on their definition, on when a subsidy is deemed to be countervailable, and on limiting the possibility of actions for harassment purposes. The degree of success of these bilateral talks will depend to a large degree on the conclusion of the Uruguay Round, which is addressing the issue of subsidies on a multilateral basis.

It is unlikely, however, that the potential for U.S. firms of launching antidumping and countervailing duty actions against Canadian producers will be completely eliminated. Thus, considering the smooth functioning of the panels so far, an important secondary objective for Canada will be to retain the current panel structure for antidumping and countervailing dispute settlement beyond its January 1995 expiry date.

Insofar as the trilateral talks on North American free trade are concerned, Canada should assess soon whether they will address issues of particular interest to its trading relationship with the United States, in a manner that will move Canadian interests substantially forward. If the NAFTA talks are not expected to yield these results, Canada should pursue the parallel launch of bilateral talks with the United States on Chapter 19 negotiations.

For negotiations with the United States to be successful, broader U.S. interests than simply greater protection from Canadian trade remedy actions will have to be advanced. Thus, both countries could commit themselves to a third round of negotiations and to otherwise deal with structural impediments to trade between them — an issue also of interest to the United States in its relations with its other trading partners.

In my view, a strong focus on North American trade is necessary and not at all incompatible with a strong commitment to the multilateralism that remains in Canada's best interest. Depending on the outcome of the Uruguay Round, this commitment may well have to be carried with greater energy to other international bodies, such as the OECD.

## Notes

1 This idea was expressed in a June 1991 *Financial Times* (London) editorial reproduced in the June 6, 1991, edition of the *Financial Post*.

2 According to a two-year review of the FTA by Canadian trade consultants Strategico Inc.

3 Recent studies by the Canada West Foundation and The Royal Bank of Canada reach similar conclusions. See Stuart A. Duncan, *On Track — Canada-U.S. Free Trade Agreement After Two Years*, in Western Perspectives (Calgary: Canada West Foundation, February 1991); and Royal Bank of Canada, "Free Trade Agreement: Second Year Retrospective," *Euroscope* special issue (February 1991).

4 The growth rates illustrated vastly understate U.S. import growth, and somewhat overstate Asian import growth, as experienced on average through the 1980s.

5 See, Alan M. Rugman and Joseph R. D'Cruz, *Fast Forward: Improving Canada's International Competitiveness* (Toronto: Kodak Canada, Toronto, 1991).

6 See R. Cecilia Siac, *The Use and Abuse of Unfair Trade Remedy Laws: The Mexican-U.S. Experience* (Toronto: Centre for International Studies, January 1991).

7 See, for example, Richard G. Lipsey, *Canada at the U.S.-Mexico Free Trade Dance: Wallflower or Partner?*, C.D. Howe Institute Commentary 20 (Toronto: C.D. Howe Institute, August 1990); and Ronald J. Wonnacott, *Canada and the U.S.-Mexico Free Trade Negotiations*, C.D. Howe Institute Commentary 21 (Toronto: C.D. Howe Institute, Sepember 1990).

## Glossary

*Antidumping.* Additional duties that are imposed by an importing country in instances where imports are priced at less than the "normal" price charged in the exporter's domestic market and are deemed to cause material injury to domestic industry in the importing country.

*Cairns Group.* Group of 14 agricultural exporters (Argentina, Australia, Brazil, Canada, Chile, Colombia, Fiji, Hungary, Indonesia, Malaysia, New Zealand, the Philippines, Thailand, and Uruguay), accounting for approximately 25 percent of global trade in agriculture, and much more for some commodities. The group, which began in 1986 as a loose coalition, has evolved into an articulate proponent of agricultural trade liberalization.

*Common market.* A common market goes beyond a customs union by allowing for the free movement of labor and capital among its members.

*Competitiveness.* The ability to design, produce, and market goods and services, the price and nonprice characteristics of which form a more attractive package than those of competitors, according to the *World Competitiveness Report.*

*Countervailing duties.* Additional duties that are imposed by the importing country to offset government subsidies in the exporting country, when the subsidized imports are deemed to cause material injury to the domestic industry in the importing country. The United States is by far the major user of this type of trade remedy action.

*Customs union.* A group of countries that have eliminated trade barriers among themselves and imposed a common tariff on all goods imported from all other countries.

*Dispute settlement mechanisms.* Those institutional provisions in a trade agreement that provide the means by which differences of view between the parties can be settled.

*Domestic content requirements.* A requirement that firms selling a particular product within a particular country must use, as a certain percentage of their inputs, goods produced within that country.

*Dumping.* The sale of an imported commodity at a price lower than that at which it is sold within the exporting country or to third countries. Dumping is generally recognized as an unfair trade practice that can disrupt markets and injure producers of competitive products in the importing country.

*European Commission.* The Commission of the European Community is the body that has the rights of initiative — that is, to propose measures to the EC Council of Ministers — and execution of EC laws and directives. It is composed of 17 commissioners appointed by the member states, and each is responsible for a "directorate-general" (portfolio). The Commission represents the EC in trade negotiations.

*European Community.* The EC comprises Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom, originally a customs union of six members (1958). It has been moving toward the creation of a Single European Market, with restrictions of movements on goods, services, labor, and capital to be lifted by the end of 1992. The EC's ultimate decisionmaking body is the Council of Ministers, consisting of heads of government or cabinet members of member states.

*European Free Trade Association.* EFTA comprises Austria, Finland, Iceland, Norway, Sweden, and Switzerland. Formed in 1960, it has been losing members to the EC, with which its members are individually linked by free trade treaties since 1972–73.

*Export subsidies.* Government payments or other financially quantifiable benefits provided to domestic producers or exporters contingent on the export of their goods and services.

*Fast track.* A procedure whereby the U.S. Congress relinquishes the right to amend international trade agreements negotiated by the administration. Instead, Congress must approve such agreements or reject them wholesale.

*Free trade area.* An arrangement among two or more countries that agree to remove substantially all tariff and nontariff barriers to trade with each

other, while each maintains its differing schedule of tariffs applying to all other countries.

*GATT.* The General Agreement on Tariffs and Trade is a multilateral treaty that delineates rules for international trade. It came into effect in 1948 and is now subscribed to by 102 countries. The primary objective of the GATT is to liberalize world trade. A small secretariat monitors the trade policies of members and helps settle trade disputes.

*Government procurement.* Purchases of goods and services by official government agencies. As a non-tariff barrier to trade, the term refers to discriminatory purchases from domestic suppliers, even when imported goods are more competitive.

*Gray-area measures.* Measures that users contend have not been demonstrated to be illegal under the GATT, although the GATT does not sanction them. Voluntary export restraints are an example of such measures.

*Green protectionism.* Refers to the danger that, as the volume of regulation dealing with legitimate environmental concerns increases, a growing number of protectionist trade measures will be legitimized as "safety" measures.

*Hub-and-spoke.* A trading system whereby one country (the "hub") has entered into free trade agreements with a number of other countries that do not have free trade among themselves (the "spokes"). In such a system, the fact that the "hub" country is the only one having access to all the markets gives it an advantage over other locations in attracting investment.

*Injury.* Term used in international commerce to describe the effect on domestic producers of a decline in output, lost sales, a decline in market share, reduced profits and return on investment, reduced capacity utilization, and so on, as a result of import competition.

*Level playing field.* Term used to describe ideal circumstances under which an exporter has access to the importer's market on terms equal to those of the importer's domestic supplier. In this sense, it is another term for *national treatment.* However, it is also used to describe the objective of a country which pressures another to modify a whole range of (legitimate) domestic and trade practices, simply to relieve its domestic industry of competitive pressure. In that sense, the term has protectionist connotations.

*Liberalization.* Reductions in tariffs and other measures that restrict world trade, unilaterally, bilaterally, or multilaterally.

*Market access.* The availability of a national market to exporting countries — that is, reflecting a government's willingness to permit imports to compete relatively unimpeded with similar domestically produced goods.

*Most-favored-nation treatment.* A commitment that a country will extend to another country the lowest tariff rates it applies to any third country. All Contracting Parties to the GATT apply MFN treatment to one another under Article I of that agreement. Exceptions to this basic rule are allowed in the formation of regional trading arrangements.

*Multifibre Arrangement.* A system of bilateral quotas governing trade in textiles, set up in 1974 between the (mostly third world) exporting countries and the (mostly industrialized) importing countries. Meant to be temporary but has been renewed three times since.

*National treatment.* This expression refers to the extension to imported goods and (where applicable) to services and foreign investors, of treatment no less favorable than that accorded to domestic products and investors with respect to internal taxes, laws, regulations, and requirements. The national treatment principle underlies much of the Canada-U.S. Free Trade Agreement.

*Nontariff barriers.* Government measures or policies, other than tariffs, that restrict or distort international trade. Examples include import quotas, discriminatory government procurement practices, and measures to protect intellectual property.

*Protectionism.* The deliberate use or encouragement of restrictions on imports to enable relatively inefficient domestic producers to compete successfully with foreign producers.

*Safeguards.* Emergency actions in the form of additional duties or import quotas applied to fairly traded imports that nevertheless cause or threaten serious injury to domestic producers.

*Sideswipe.* Said to occur when one country is affected by another country's trade-restraining (or retaliatory) measures that are specifically aimed at others.

*Subsidies code.* A code of conduct establishing both substantive and procedural standards for national countervailing duty proceedings, and clarifying just what subsidies are not subject to countervail duties.

*Subsidy.* An economic benefit granted by a government to producers of goods, often to strengthen their competitive position. The subsidy may be direct (a cash grant) or indirect (low-interest export credits guaranteed by a government agency, for example).

*Tariff.* A duty (or tax) levied on goods transported from one country to another. Tariffs raise the prices of imported goods, thus making them less competitive within the market of the importing country. The tariff rate is the rate at which imported goods are taxed.

*Trade remedy laws* (also called *fair trade laws*). A set of domestic laws governing the rules of international trade. These laws allow trade restrictions to be placed on "unfair" competition from foreign exports whenever such exports injure domestic industry.

*Unfair trade.* Term used in the United States to describe trade in dumped, subsidized, or counterfeit goods. The term's application has steadily widened as U.S. trade remedy laws have defined new practices that are considered to harm the export and import interests of U.S. companies. Thus, according to U.S. trade laws, unfair practices now come under three categories: unjustifiable, unreasonable (a catch-all category), and discriminatory.

*Uruguay Round.* The eighth in a series of multilateral trade negotiations held under the auspices of the GATT. This round was launched at Punta del Este, Uruguay, in September 1986.

*Voluntary export restraints.* Informal arrangements by which exporters voluntarily restrain certain exports, usually through export quotas, to avoid economic dislocation in an importing country and to avert the possible imposition of mandatory import restrictions. Such arrangements normally do not entail "compensation" for the exporting country.

This Glossary is a modified version of one prepared by Richard G. Lipsey and Robert C. York for *Evaluating the Free Trade Deal: A Guided Tour through the Canada-U.S. Agreement* (Toronto: C.D. Howe Institute, 1988), itself a selection from Canada, Department of External Affairs, *Canada-U.S. Trade Negotiations: Glossary* (Ottawa, 1987). Other material was drawn from Alan Oxley, *The Challenge of Free Trade* (Hemel Hempstead, U.K.: Harvester Wheatsheaf, 1990); Sylvia Ostry, *Governments & Corporations in a Shrinking World: Trade & Innovation Policies in the United States, Europe & Japan* (New York: Council on Foreign Relations, 1990); and Alan M. Rugman and Joseph R. D'Cruz, *Fast Forward: Improving Canada's International Competitiveness* (Toronto: Kodak Canada, 1991).

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